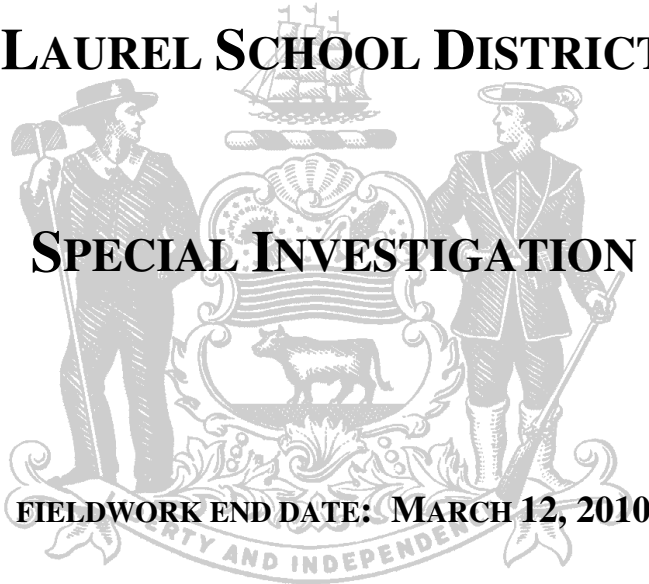


STATE OF DELAWARE

OFFICE OF AUDITOR OF ACCOUNTS

LAUREL SCHOOL DISTRICT



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State of Delaware
Office of Auditor of Accounts
R. Thomas Wagner, Jr. – CFE, CGFM, CICA
At a Glance

Working Hard to Protect YOUR Tax Dollars

Why We Did This Review

The Office of Auditor of Accounts (AOA) received the following allegation regarding the Finance Director at the Laurel School District:

Upon resigning, the Finance Director of the Laurel School District admitted to the Board Chair and Superintendent that he had discovered a flaw in the PHRST payroll system. The flaw allowed the Finance Director to fraudulently adjust his pay through the use of the Extra Pay for Extra Responsibilities (EPER) and retro pay codes.

Background

Laurel School District, located in Laurel, Delaware, consists of two elementary schools, an intermediate school, a middle school, and a high school. For the 2008 – 2009 school year, there were 2,092 students enrolled in the Laurel School District. The District expenditure per pupil was \$11,146 for the 2008 – 2009 school year. The Laurel School District receives 78% of its revenue from State Funding, 14% from Local Funding, and 8% from Federal Funding.

The District's former Finance Director was employed from January 1996 through December 2009.

For further information on this release, please contact:

Christopher Cooper
(302) 857-3935

Laurel School District

What We Found

- A total of \$151,332.21 was fraudulently paid to the District's former Finance Director.
- The District underpaid six administrators a total of \$40,758 and one Assistant Principal a total of \$4,845 for the 2009 – 2010 school year. In addition, the District overpaid a Data Management Analyst a total of \$8,796 for the 2007 – 2010 school years.
- The District had \$14,810 in unsupported EPER payments during Fiscal Year 2007 through Fiscal Year 2010.
- Of the 387 expenditure documents reviewed by AOA, 5 documents did not have the required two authorizing signatures and 12 did not have proper supporting documentation.
- The District expended more funds than necessary for vehicle use.
- The District has insufficient and outdated policies and procedures that do not reflect current practices.
- A lack of segregation exists within the District.
- Employee leaves of absence were not properly documented and calculated by the former Finance Director, causing the District to owe funds to employees and be owed funds from employees.

What We Recommend

- The District should seek restitution of the \$151,332.21 in fraudulent pay.
- The District should document a standard salary calculation methodology and, once in place, the District should create and implement an action plan to rectify the incorrect salary calculations.
- The District should implement proper controls to ensure adequate supporting documentation is maintained with all financial documents.
- The District should incorporate the Statewide Travel Policy into their policies and procedures.
- The District's internal policies and procedures should be updated for current financial processes.
- The District should implement an internal control structure that ensures proper segregation of duties and ensures compliance with the State of Delaware *Budget and Accounting Manual*.
- The District should (1) implement internal controls and policies and procedures surrounding the payroll function and employee leave records and (2) re-examine all leave documentation in order to properly recalculate the leave balance and amounts owed.
- The allegation regarding the former Finance Director was referred to the Office of the Attorney General for further review.

Please read the complete report for a full list of findings/recommendations and to review the Laurel School District's response to our findings.

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AUDIT AUTHORITY

Title 29, Del. C. c. 29 authorizes the Auditor of Accounts to file written reports containing:

1. Whether all expenditures have been for the purpose authorized in the appropriations;
2. Whether all receipts have been accounted for and paid into the State Treasury as required by law;
3. All illegal and unbusinesslike practices;
4. Recommendations for greater simplicity, accuracy, efficiency, and economy; and
5. Such data, information, and recommendations as the Auditor of Accounts may deem advisable and necessary.

ALLEGATION AND BACKGROUND

ALLEGATION

The Office of Auditor of Accounts (AOA) received the following allegation regarding the Finance Director at the Laurel School District:

- Upon resigning, the Finance Director of the Laurel School District admitted to the Board President and Superintendent that he had discovered a flaw in the PHRST payroll system. The flaw allowed the Finance Director to fraudulently adjust his pay through the use of the Extra Pay for Extra Responsibilities (EPER) and retroactive pay codes.

BACKGROUND

Laurel School District, located in Laurel, Delaware, consists of two elementary schools, an intermediate school, a middle school, and a high school. For the 2008 – 2009 school year, there were 2,092 students enrolled in the Laurel School District and expenditures per pupil were \$11,146. The Laurel School District receives 78% of its revenue from State Funding, 14% from Local Funding, and 8% from Federal Funding.

The former Finance Director was employed by the District from January 1996 through December 2009.

OBJECTIVES, SCOPE, & METHODOLOGY

OBJECTIVES

There were two objectives of this investigation:

- To determine the amount of salary funds embezzled from the District.
- To determine if other funds were embezzled from the District.

SCOPE

The scope of the investigation included:

- 100% review of the former Finance Director's payroll activity during FY02 – FY10, through January 2, 2010.
- Review of other District employees' payroll activity during FY07 – FY10, through January 2, 2010.
- Review of vendor activity deemed questionable by AOA for FY07 – FY10, through December 31, 2009.
- 100% review of Board approved leave of absences for FY09 – FY10, through December 1, 2009.

The investigation was performed in accordance with the President's Council on Integrity and Efficiency, *Quality Standards for Investigations*.

METHODOLOGY

Investigative techniques included:

- Interviews and inquiry.
- Inspection and confirmation of documentation.

CONCLUSIONS

Allegation

The Office of Auditor of Accounts (AOA) received the following allegation regarding the Finance Director at the Laurel School District:

- Upon resigning, the Finance Director of the Laurel School District admitted to the Board President and Superintendent that he had discovered a flaw in the PHRST payroll system. The flaw allowed the Finance Director to fraudulently adjust his pay through the use of the Extra Pay for Extra Responsibilities (EPER) and retroactive pay codes.

Results of Testing

- The former Finance Director was responsible for processing and approving payroll at the Laurel School District.
- The former Finance Director had the ability to authorize retroactive pay and EPER pay on his own profile in the PHRST payroll system.
- From September 8, 2001 through October 10, 2009, the former Finance Director received \$89,490.34 in unauthorized retroactive pay and \$61,841.87 in unauthorized EPER pay.
- AOA could not find support authorizing the payments and District officials were unable to provide an explanation for the retroactive and EPER payments.
- The former Finance Director manually implemented the July 1, 2009 2.5% statewide pay reduction for the Laurel School District; however, he did not receive the 2.5% statewide pay reduction until November 2009.
- The allegation regarding the former Finance Director was referred to the Office of the Attorney General for further review.

Conclusion

Substantiated.

FINDINGS & RECOMMENDATIONS

Finding #1: Finance Director's Salary

Criteria

Internal Control-Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines control activities as ". . . policies and procedures that help ensure management directives are carried out. . . ." Management review controls are defined as the activities of a person different than the preparer analyzing and performing oversight of activities performed and is an integral part of any internal control structure.

Condition

In reviewing the former Finance Director's salary, AOA determined the following:

- From September 8, 2001 through October 10, 2009, the former Finance Director received \$89,490.34 in unauthorized retroactive pay and \$61,841.87 in unauthorized EPER pay. AOA could not find support authorizing the payments and District officials were unable to provide an explanation for the retroactive and EPER payments.
- AOA recalculated the former Finance Director's salary and determined that his regular salary was \$10,618 less than it should have been from Fiscal Year 2002 through Fiscal Year 2010.
- Despite pay reductions taken by other District employees on July 1, 2009, the former Finance Director did not receive a reduction to his regular annual salary until November 2009.

Cause

The District did not have effective internal controls surrounding the payroll function. The former Finance Director processed the District's payroll and there was no management review of his salary.

Effect

Per discussions with District officials, a total of \$151,332.21 was fraudulently paid to the District's former Finance Director.

Recommendation

The District should implement proper internal controls over both DFMS and PHRST financial transactions, including separating the preparation and review functions. The District should also seek restitution of the \$151,332.21 in fraudulent pay. Of the \$151,332.21, \$4,539.97 was inappropriately paid into the State's pension fund on behalf of the employee.

Auditee Response

The District has begun the process of incorporating a series of internal controls such as those outlined in the document from COSO entitled *Internal Control-Integrated Framework*. We self-reported to and have worked closely with the auditor's office and will follow up with legal counsel for the District and with the Attorney General's Office in an effort to pursue all available legal avenues to recover all funds that were improperly taken by the former Finance Director. We will also seek to recover interest on these funds and any attorney's fees incurred in our efforts to recover the funds the former Financial Director improperly paid himself.

FINDINGS & RECOMMENDATIONS

Finding #2: Incorrect Salary Calculations

Criteria

Delaware Code, Title 14, Section 1321(c) states, "Each teacher, specialist, supervisor, administrative assistant, director, and assistant superintendent employed by a district and having the qualifications required by the certifying board shall receive as an annual salary the amount for which he or she qualifies under Section 1305(a), (b) and (d) of this title, plus an annual amount for administrative responsibility."

Internal Control-Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines control activities as ". . . policies and procedures that help ensure management directives are carried out. . . ." Management review controls are defined as the activities of a person different than the preparer analyzing and performing oversight of activities performed and is an integral part of any internal control structure.

Condition

AOA recalculated the salaries of select District personnel and found the following:

- The District underpaid six administrators a total of \$40,758 for the 2009-2010 school year.
- The District underpaid one Assistant Principal \$2,947 in retroactive payments and \$1,898 related to a state mandated responsibility index for the 2009-2010 school year.
- The District overpaid a Data Management Analyst a total of \$8,796 for the 2007-2010 school years.

District policy did not specifically address whether the Local Board Factor for administrators included a factor for the annualizing of 10-month salaries. To be conservative, AOA assumed the factor annualized the 10-month salary.

Cause

The former Finance Director incorrectly calculated the salaries stated above; the District did not have a separate review in place to detect the errors.

Effect

Based on AOA's calculations, the District underpaid the employees reviewed by a net amount of \$36,807.

Recommendation

AOA recommends that the District perform the following:

- Document a standard salary calculation methodology in the policies and procedures using Title 14, Chapter 13 of the Delaware Code as a reference.
- Clarify the policy with the Laurel School District Board of Education regarding the local factor for administrators.
- Once a standard salary calculation is in place, assess the impact on salaries within the District.
- Create and implement an action plan to rectify the incorrect salary calculations.

FINDINGS & RECOMMENDATIONS

- Implement a management review and segregation of duties in which the individual preparing the salary schedules is (1) separate from the reviewer approving them and (2) different from the individual who inputs the salary in PHRST.

Auditee Response

The District is in the process of clearly defining the standard salary calculation methodology for administrators, the application of the local factor when considering administrative salaries, assessing the impact on salaries and developing an action plan to rectify the incorrect salary calculations from this point forward, and implement a management review and segregation of duties relative to salary approvals and inputting of salaries in PHRST.

Finding #3: Lack of Supporting Documentation - EPER Pay

Criteria

Internal Control - Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), defines control activities as ". . . policies and procedures that help ensure management directives are carried out. . . . Control activities occur throughout an organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties." To ensure control activities meet the objectives of management, supporting documentation for all such activities should be referred to or maintained with the financial documents.

Condition

Of the 450 EPER payments reviewed, the District did not maintain proper supporting documentation for 20 EPER payments. District officials verbally acknowledged that it was appropriate for those employees to receive EPER payments; however, overtime forms or EPER contracts for these payments could not be provided.

Cause

Internal controls are not in place or operating effectively over payroll processing and filing.

Effect

The District had \$14,810 in unsupported EPER payments during Fiscal Year 2007 through Fiscal Year 2010.

Recommendation

The District should implement proper controls to ensure that adequate supporting documentation is maintained with all financial documents.

Auditee Response

The District is in the process of establishing stricter controls within the business office to ensure adequate supporting documentation is maintained in respect to all EPER payments. District employees involved in documenting and approving these payments will be required to be more diligent in obtaining and maintaining all relevant supporting documentation.

FINDINGS & RECOMMENDATIONS

Finding #4: Control Weaknesses over Expenditures

Criteria

Internal Control - Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), defines control activities as ". . . policies and procedures that help ensure management directives are carried out. . . . Control activities occur throughout an organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties." To ensure control activities meet the objectives of management, supporting documentation for all such activities should be referred to or maintained with the financial documents. In addition, management review controls are defined as the activities of a person different than the preparer analyzing and performing oversight of activities performed and its integral part of any internal control structure.

Condition

Of the 387 expenditure documents reviewed during the course of the investigation, 5 documents did not have the required two authorizing signatures and 12 did not have proper supporting documentation.

Cause

The lack of a proper control structure within the District's Finance function allowed for insufficient authorizations and support of these transactions.

Effect

Financial documents were not properly supported and authorized, which could lead to the misappropriation of assets.

Recommendation

All paper financial documents should not be processed unless two authorized signatures and adequate supporting documentation are maintained with each document.

Auditee Response

The District recognizes the need for stricter internal controls and is in the process of implementing the various aspects of segregation of duties, such as the consistent enforcement of the use of two signatures when processing financial documents, which will add to the internal control structure.

Finding #5: Inefficient Use of State Vehicles

Criteria

Chapter XIII, Section C, 2, c of the State of Delaware *Budget and Accounting Manual* states, "Vehicles from Delaware Fleet Services shall be used for in-state travel and thus reimbursement for use of privately owned vehicles for in-state travel is discouraged. Organizations may allow exceptions to this policy but in no case should the total amount reimbursed for in-state mileage to an individual on a single day exceed the Delaware Fleet Services daily rental rate."

FINDINGS & RECOMMENDATIONS

Condition

The District maintains blocked Fleet vehicles for the use of the District's employees. During a review of expenditure documents, AOA noted that employees are reimbursed for their personal vehicle mileage when conducting District business, instead of using the blocked vehicles at the District or obtaining a State vehicle from a Fleet location. During one instance in Fiscal Year 2009, \$98.90 was unnecessarily charged to the District when there were no blocked vehicles available because an employee used their personal car instead of obtaining a Fleet vehicle from another location. In addition, \$249.60 was charged on the same document for mileage even though a District blocked vehicle was available.

Cause

District officials were unaware of the regulation mentioned above.

Effect

The District expended more funds than necessary for vehicle use.

Recommendation

The District should incorporate the Statewide Travel Policy into their operating policies and procedures and discourage personal mileage reimbursement unless a unique circumstance exists. If it is inefficient for an employee to drive to the District office to pick up a Fleet vehicle, they should reserve a vehicle from an alternate Fleet location.

Auditee Response

The auditors brought to the attention of the District this particular aspect of the Statewide Travel Policy. Immediately thereafter, changes were made the next day to more fully align our practices with the travel policy. District employees will no longer be reimbursed for in-state travel under the Statewide Travel Policy for using private vehicles, and have been directed to utilize vehicles from other service areas around the state if a local vehicle is not available, provided a vehicle is available from the State pool.

Finding #6: Outdated Policies and Procedures

Criteria

Chapter II, Section C of the State of Delaware *Budget and Accounting Manual* states, "A well designed system of controls must include written policies and procedures to ensure that each control objective is met."

Internal Control - Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), defines control activities as ". . . policies and procedures that help ensure that management's directives are carried out." Policies and procedures must be current to ensure management's control objectives are met.

Condition

The District has insufficient and outdated policies and procedures that do not reflect current practices. In addition, there are no detailed procedures for recording and approving payroll activity such as overtime, extra pay for extra responsibilities (EPER), and retroactive pay.

FINDINGS & RECOMMENDATIONS

Cause

The District does not continuously update their policies and procedures.

Effect

Written policies and procedures help promote effective accounting control over assets, liabilities, revenues, and expenditures. By not maintaining adequate policies and procedures, the District has no true method of ensuring efficient and effective organizational operation. Inadequate policies and procedures can allow financial personnel to disguise the embezzlement of salary funds by coding items such as overtime and salary stipends to other pay codes.

Recommendation

The District's internal policies and procedures should be updated to reflect:

- New or updated processes and regulations; and,
- The processing, review, and reconciliation of all financial transactions, including DFMS receipts and disbursements and payroll transactions.

Auditee Response

The District will take timely steps to identify and correct any areas where its financial management policies are inconsistent with the policies contained in the State *Budget and Accounting Manual*.

Finding #7: Segregation of Duties

Criteria

The State of Delaware *Budget and Accounting Manual*, Chapter II, Section B states "One of the basic and most successful methods of achieving internal control is through the segregation of duties. The segregation of duties divides the responsibility for a transaction or activity among different parties so that no one employee has complete control over the processing of transactions. This method of control increases the likelihood that if one person makes an error, another will discover it. Segregation of duties also reduces the risk that one person would perpetrate and/or conceal errors in the normal course of his or her duties."

Condition

The District's former Finance Director was responsible for calculating employee salaries and leave, entering data into the State's payroll system (PHRST), processing and reviewing District payroll, approving District payroll in PHRST, and preparing financial reports.

Cause

The internal control structure was monitored by the District's former Finance Director.

Effect

A lack of segregation of duties, which can lead to a misappropriation of assets, exists within the District.

FINDINGS & RECOMMENDATIONS

Recommendation

The District should implement an internal control structure that ensures proper segregation of duties and ensures compliance with the State of Delaware Budget and Accounting Manual.

Auditee Response

The District recognizes the importance of the proper segregation of duties and will effectively segregate duties within the business department to separate the input and review functions. Furthermore, we will work toward full compliance with the State of Delaware *Budget and Accounting Manual* in as quickly and efficiently as possible.

Finding #8: Inappropriate Recording of Leave

Criteria

Internal Control - Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), defines control activities as ". . . policies and procedures that help ensure management directives are carried out. . . . Control activities occur throughout an organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties." To ensure control activities meet the objectives of management, supporting documentation for all such activities should be referred to or maintained with the financial documents. In addition, management review controls are defined as the activities of a person different than the preparer analyzing and performing oversight of activities performed and its integral part of any internal control structure.

Delaware Code, Title 14, Chapter 13, § 1318 (a) states, "Teachers and other school employees shall be allowed 10 days of sick leave per year with full pay; those teachers and other school employees employed 11 months a year shall be allowed 11 days of sick leave per year with full pay; and those teachers and other school employees employed 12 months a year shall be allowed 12 days of sick leave per year with full pay. Any unused days of such leave shall be accumulated to the employee's credit without limit."

Condition

During the course of the investigation, it came to AOA's attention that there were employees who took a leave of absence and received at least a portion of their regular paycheck during this period. A portion of the employees' pay would be deducted from each paycheck throughout the year to compensate for the absence. Of the 31 Fiscal Year 2009 and Fiscal Year 2010 leaves of absence reviewed by AOA, 9 employees were receiving a pay deduction for an approved absence. In addition, these employees may have been receiving benefits in which they were not entitled to during the absence.

Based on the leave records and documentation maintained at the District, AOA determined that 26 of the 31 absences reviewed were not properly documented. AOA noted the following:

- Seven employees reviewed had accrued enough leave to cover the duration of their leave of absence; however, the former Finance Director did not properly reduce the employees' sick leave balance. The District undercharged these employees 90.25 days.

FINDINGS & RECOMMENDATIONS

- Four employees reviewed were receiving Short-Term Disability benefits and did not have sufficient time accrued to cover the duration of their leave of absence. AOA is unable to determine the amount owed to the District due to the employees' insufficient leave records.
- Three employees reviewed were receiving Short-Term Disability benefits and did not have sufficient time accrued to cover the entire leave of absence. Based on the leave documents provided by the District and, assuming the employees returned on the agreed upon dates, the District is due approximately \$12,500 from these employees, as they should have been on an 'unpaid leave of absence.'
- Nine employees reviewed were not receiving disability benefits and did not have sufficient sick time accrued to cover the entire leave of absence. Based on the leave documents provided by the District and, assuming the employees returned on the agreed upon dates, the District is due approximately \$26,600 from these employees, as they should have been on an 'unpaid leave of absence.'
- Three employees reviewed were overcharged for their leave of absence. Based on the leave documents provided by the District, the District owes approximately \$6,000 to the employees who were overcharged.

Cause

The District did not provide proper oversight of the former Finance Director's calculations of employee leaves of absence. In addition, AOA noted a lack of segregation of duties surrounding the leave records and corresponding payroll documents, as all related documents were prepared and approved by the former Finance Director.

Effect

The District is due approximately \$39,100 from the employees who did not have sufficient sick leave accrued to cover their leave of absence. The District owes approximately \$6,000 to the employees who were overcharged for their leave of absence.

The amounts calculated above were based on documents prepared by the former Finance Director, and given the discrepancies noted by AOA within these documents, the District should re-examine all leave documentation in order to recalculate leave balances and determine the full extent of funds owed to the employees and/or to the District.

Recommendation

The District should implement internal controls and policies and procedures surrounding the payroll function and employee leaves of absence.

Additionally, the District should recalculate the employee leave balances and amounts due to the employees and/or to the District for the discrepancies in the leave calculations. As previously stated, the amounts calculated above were based on documents prepared by the former Finance Director, and given the discrepancies noted by AOA within these documents, the District should re-examine all leave documentation in order to properly recalculate the leave balances and amounts owed.

FINDINGS & RECOMMENDATIONS

Auditee Response

Employee leave issues are of great concern. It is the District's intent to rectify the errors committed by the former Finance Director. A review of the status and entitlement of all those individuals currently on leave is now underway to determine their eligibility and longevity of any previously approved leave.

DISTRIBUTION OF REPORT

Copies of this report have been distributed to the following public officials:

The Honorable Jack A. Markell, Governor, State of Delaware
The Honorable Russell T. Larson, Controller General, Office of the Controller General
The Honorable Joseph R. Biden, III, Attorney General, Office of the Attorney General
The Honorable Ann Visalli, Director, Office of Management and Budget
The Honorable Robert L. Venables, Sr., Senator, Delaware State Senate
The Honorable Clifford G. Lee, Representative, Delaware House of Representatives
The Honorable Lillian Lowery, Secretary, Department of Education
Mr. Michael Jackson, Associate Secretary, Department of Education
Mr. Tim Mullaney, Deputy Attorney General, Office of the Attorney General

Officials of Audited Entity

Dr. John McCoy, Superintendent, Laurel School District
Ms. Linda Schenck, Assistant Superintendent, Laurel School District
Mr. Jerry White, President, Laurel School District Board of Education
Ms. Dorothy Hickman, Vice President, Laurel School District Board of Education